TESTIMONY SUBMITTED TO
THE HOUSE COMMITTEE ON ENERGY AND COMMERCE
BY VICTOR CARRILLO, CHAIRMAN, TEXAS RAILROAD COMMISSION
REPRESENTING THE INTERSTATE OIL AND GAS COMPACT COMMISSION
FEBRUARY 10, 2005

ONE PAGE SUMMARY OF TESTIMONY

Victor Carrillo is Chairman of the Railroad Commission of Texas. He is representing the Interstate Oil and Gas Compact Commission (IOGCC). The member states of the IOGCC produce more than 99% of the oil and natural gas produced onshore in the United States. The organization is a congressionally ratified interstate compact and includes 30 member and 7 associate states. Always chaired by a Governor, its Chairman in 2005 is Governor Murkowski of Alaska.

It may come as a surprise to most Americans to learn that we Americans are still our own biggest supplier of oil – produced domestically either onshore or offshore.

With this ignorance of the role of America in supplying its own oil and natural gas, comes acceptance that importing more oil is our best or only option. It isn't. With the right policies in place it most certainly doesn't have to be.

No country in the world produces its oil and natural gas to higher environmental standards. Yet here at home we remain preoccupied with potential harm to the environment that will be done when we produce here at home – never really getting the facts but willing to accept most of our information from the soundbite-sized wails of the most vocal nay-sayers.

With the right policies in place there is nothing that should stop America in the years ahead from remaining its own biggest supplier of oil and natural gas -- to the benefit of all of America. But America does need a policy from the top that recognizes the possibilities and moves us toward solutions.

The bill before this committee today, the Energy Policy Act of 2005, is a very positive step forward. The oil and natural gas provisions of this bill do advance the cause of helping America to maximize the production of its domestic oil and natural gas resource.

Provisions in the bill of which the IOGCC is highly supportive include: Research and Development, Access to Public Lands, Tax Incentives, Marginal Oil and Natural Gas Wells, Orphaned and Abandoned Wells, Stormwater Runoff and Energy Education.

IOGCC states are very concerned with the Administration's proposal in this week's budget submission to Congress to terminate the Fossil Energy Oil and Natural Gas Program at the U.S. Department of Energy (DOE). The IOGCC believes strongly that DOE's Fossil Energy Oil and Natural Gas R&D Program is absolutely necessary in order for United States domestic producers to keep pace technologically. We encourage this committee to voice its concerns with the Administration's proposals in this area.

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Good afternoon. My name is Victor Carrillo. I am the Chairman of the Railroad Commission of Texas. I am here today representing the Interstate Oil and Gas Compact Commission (IOGCC). With the permission of the committee, I'd like to submit a statement and the attached publications for the record. My statement today will highlight those comments.

The member states of the IOGCC produce more than 99% of the oil and natural gas produced onshore in the United States. Formed in 1935, the IOGCC is a congressionally ratified interstate compact. As an organization, the IOGCC is the nation's leading advocate for conservation and wise development of domestic petroleum resources. The organization includes 30 member and 7 associate states. The mission of the IOGCC is two-fold: to conserve our nation's oil and gas resources and to protect human health and the environment. Always chaired by a Governor, our Chairman in 2005 is Governor Murkowski of Alaska.

We hear a lot about imported oil – about our dependence in this country on upon foreign oil. It may come as a surprise, however, to most Americans to learn that we Americans are still our own biggest supplier of oil – produced domestically either onshore or offshore. This is by and large production from our states, like my state, the state of Texas or the 29 other member states of the IOGCC. Together we still produce most of the energy we so critically need -- to fuel our cars, heat our homes, and power this country's economy.

It seems at times that with this ignorance of the role of America in supplying its own oil and natural gas, comes acceptance that importing more oil is our best or only option. It isn't. With the right policies in place it most certainly doesn't have to be. Plus, no country in the world produces its oil and natural gas to higher environmental standards. The states are proud of these environmental standards – and yes it is largely state standards, not federal standards, which dictate how our oil and natural gas is produced here at home.

Much of the oil we import is produced with lower environmental standards, risking ground and surface waters, and often with rampant flaring of natural gas that is produced along with the oil but where no market for that gas exists. Every barrel of oil imported must also ply the high seas in tankers risking the world's shorelines.

Yet here at home we often wring our hands and bemoan the harm to the environment that will be done when we produce here at home – never really getting the facts but willing to accept most of our information from the soundbite-sized wails of the most vocal nay-sayers. I am here to report, however, that the sky isn't really falling.

I'd also like to point out that while my state of Texas and the other member states of the IOGCC are oil and natural gas producing states, we are also consuming states and therefore share all of the concerns of states without oil and natural gas production. We all need a steady source of supply at reasonable and steady prices. A secure source of domestically produced oil and natural gas is in all of our interests – producing and consuming state alike.

Thus one message I would like to convey here today is that with the right policies in place there is nothing that should stop America in the years ahead from remaining its own biggest supplier of oil and natural gas -- to the benefit of all of America. But America does need a policy from the top that recognizes the possibilities and moves us toward solutions. Several years ago the IOGCC produced an energy policy document entitled "A Dependent Nation: How Federal Oil & Natural Gas Policy is Eroding America's Economic Independence." A copy of this document is attached for the record. In this document the governors from oil and natural gas producing states, through the IOGCC, offer their views of what our national energy policy should be. This document defines the true cost of imported oil, promotes the expansion of research and development efforts, urges a re-examination of oil and natural gas development policies and encourages the conservation of the nation's petroleum resources.

My own state of Texas has recently undertaken a process to produce a Texas Energy Plan 2005. Created by the Texas Energy Planning Council, the Texas Energy Plan 2005 contains 10 recommendations – forming a blueprint of energy issues and actions for the state's lawmakers to take under consideration this year. As Chairman of the council, I worked with 21 energy production legislative and industry leaders to come up with these recommendations. While I don't have the ability to detail these actions today, I feel strongly that we have addressed the key energy issues facing Texas. The plan's recommendations address many of the same issues dealt with in the Energy Policy Act of 2005 and which I will highlight today. These include Tax Incentives, Marginal Well Incentives, Energy Education and Research and Development.

Based on my experience in Texas, I can say that the bill before this committee today, the Energy Policy Act of 2005, is a very positive step forward. The oil and natural gas provisions of this bill do advance the cause of helping America to maximize the production of its domestic oil and natural gas resource.

I will address some of these provisions directly.

First, however, I would like to voice a grave concern of the oil and natural gas producing states concerning the Administration's proposal in this week's budget submission to Congress to terminate the Fossil Energy Oil and Natural Gas Program at the U.S. Department of Energy (DOE). The IOGCC believes strongly that DOE's Fossil Energy Oil and Natural Gas R&D Program is absolutely necessary in order for United States domestic producers to keep pace technologically. Our small and medium-sized oil and natural gas producers – who drill most of the wells onshore in the U.S. – do not have the budgets to conduct their own R&D. The modest DOE Fossil Energy oil and natural gas budget (just under $80 million last year) provides our domestic producers with the technological edge to keep producing and to keep domestically produced oil and natural gas flowing into our economy.

R&D spending can help lower finding costs, improve drilling efficiency and recovery rates, prolong production from marginally economic wells, minimize losses to the atmosphere, improve transportation efficiency and the updating of infrastructure. The U.S. Department of Energy has done a remarkable job with a tiny research budget over the years. Not only do we not recommend terminating this valuable program but would recommend yearly increases in research dollars directed toward oil and natural gas research and development. We encourage this committee to voice its concerns with the Administration's proposals in this area.

I have attached a copy of the IOGCC publication entitled "Who Will Fund America's Energy Future." IOGCC Resolution 03.102 concerning R&D is also attached.

The following are some specific comments on the oil and natural gas provisions contained in the Energy Policy Act of 2005:

Access to Public Lands. One of the ways we can expand our domestic oil and natural gas supply – to bring more domestically produced oil and natural gas to market – is to more fully appreciate the crucial role public lands and access to those public lands play in assuring adequate supplies of domestically-produced oil and natural gas. The states of the IOGCC do not believe that the role public lands play in ensuring heat for our homes and power for our economy is adequately appreciated by energy-consuming America.

We also need public lands on which to build the pipelines and other infrastructure necessary to bring oil and natural gas into our cities and into our homes. Restricted access to public lands also impacts the ability to build the pipelines necessary to transport that resource, particularly natural gas, to markets.

Access restrictions come in a myriad of forms, some more obvious and some more onerous than others. They range from outright prohibition on activities to new processes and requirements which slow and increase the cost of drilling or building necessary pipeline or other infrastructure.

Examples of outright prohibitions on public access include Monument designations and the U.S. Forest Service's Roadless Plan. This Roadless Plan as initially proposed would have prohibited road building in 58.5 million acres of public lands where no roads presently exist. Reports in the press indicated that this plan could lock up more than 20 TCF of natural gas. This is equivalent to approximately one year of present U.S. natural gas demand.

We applaud those provisions of the Energy Policy Act of 2005 which attempt to address this complex issue. IOGCC Resolution 02.123 is attached. Resolution 02.123 urges "the Need the a National Energy Policy and Increased Access to Public Lands for Environmentally Sound Natural Gas and Oil Production."

Tax Incentives. Tax incentives are a powerful tool to help increase the supply of natural gas. The states have proven this with their own tax incentives and IOGCC studies have documented the success of state tax incentives. Reference is made in particular to two IOGCC publications: "Making a Wise Investment: The Economic Impact of Oil and Gas Incentives" and "Investments in Energy Security: State Incentives to Maximize Oil and Gas Recovery." Copies of both IOGCC publications are attached.

The incentive programs to assist the oil and natural gas industry, documented in these publications, have proven to be a valuable countermeasure against global price volatility. In 1999, when Investments in Energy Security was first published, 28 states reported some type of oil and natural gas incentive program. Basically these incentives fell into two categories: those providing some type of tax benefit (monetary) and those that are beneficial while providing no direct state monetary relief.

The combined impact of the incentives was a net $113.2 billion in economic effects. States invested $2.8 billion to generate these economic effects through tax reductions. This $2.8 billion helped ensure more than 30 times that much for state economies. In turn, states investing the $2.5 billion received more than $9 billion in state and local taxes, yielding an additional $2 for every dollar invested.

Additionally, a principal beneficiary of state efforts was the federal government, which realized approximately $2.5 billion in additional tax revenue while the states shouldered the risk.

Had these incentives not been in place, many wells, particularly marginal oil and natural gas wells (defined as wells producing 10 barrels or less per day of oil or 60 Mcf or less of natural gas) would have been abandoned during the 1997-1998 price collapse. This would have meant valuable oil and natural gas lost forever. Had these wells been abandoned during the price collapse, the state and local economies would have lost almost $400 million in revenue. More importantly, the collective economies would have lost $3.5 billion.

While difficult to enact in tough economic times, the incentive programs adopted by the states represented a fortress standing alone against global vicissitudes, protecting both the domestic oil and natural gas industry and all state economies.

Reference is also made to the attached IOGCC Resolution 02-122 “Pertaining to a Heightening National Crisis in Natural Gas Production and Supply Stability”. Among other things the resolution calls for the President and Congress, in consultation with the states, to adopt without delay measures which will create long-term incentives for the development of conventional and unconventional sources of domestic natural gas and oil through the extension of existing programs and the development of new initiatives including, but not limited to, the extension of Tax Code Section 29 credit for production from unconventional sources.

Marginal Wells. Another important issue is marginal wells. I am attaching a copy of the 2004 edition of the IOGCC’s publication entitled “Marginal Oil and Gas: Fuel for Economic Growth.” This report represents the only place where one can obtain statistics on marginal oil and natural gas wells in the United States. Marginal wells are wells that produce miniscule quantities of oil and natural gas daily. (Marginal oil wells are defined as wells producing 10 barrels of oil per day or less. Marginal gas wells are defined as producing 60 thousand cubic feet (Mcf) per day or less.) In most parts of the world, these wells would have been shut in years ago. In America, they are a significant energy resource. Marginal oil wells in America produce about 15% of our domestic oil production and over 7% of our natural gas production. There are almost 400,000 marginal oil wells that produced more than 313 million barrels of oil in 2003.

The reason they exist is largely because of tax incentives from the states that allowed them to remain economic in years when oil prices were low. Now that they are high again, these wells remain to contribute to our country's energy needs.

The energy bill has several provisions dealing with marginal wells and we applaud Congress' recognition of this important national resource.

Orphaned and Abandoned Wells. There exist in the United States approximately 57,000 "orphan" oil and natural gas wells. These are wells that are no longer being produced, are idle without approval of the state, and for which the operator (who drilled and/or operated the wells) is unknown or insolvent. The wells were usually drilled and operated before states began rigorous regulation of oil and natural gas production. The wells often pose a significant environmental risk – of contamination of ground and surface waters – unless and until they are properly plugged and abandoned under supervision of the state. While most states have resources directed to solving this problem, it is never enough to take care of the problem. I have attached the IOGCC publication entitled "Produce or Plug?: The Dilemma over the Nation's Idle Oil and Natural Gas Wells."

The Energy Policy Act of 2005contains important provisions which addresses the orphaned and abandoned well issue in three respects: 1) assessing and addressing the problem on Federal land, 2) authorizing a program of technical assistance to the states through the IOGCC, and 3) creating an Orphaned Well Reclamation Pilot Program. The IOGCC strongly supports these provisions.

Hydraulic Fracturing Regulation. Another issue that has the potential to limit natural gas development in the future is the impact of the LEAF v EPA decision on hydraulic fracturing in the United States. Hydraulic fracturing is a decade's old process for completing over 90% of the oil and natural gas wells drilled in the United States. In the past, the states have been responsible for regulating this process. In 1994, an environmental group in Alabama sued the Environmental Protection Agency contending that natural gas wells should be regulated as underground injection wells under the Safe Drinking Water Act (SDWA). Based on the definition of "injection" contained in the SDWA, the 11th Circuit Court of Appeals ruled that the EPA should regulate hydraulic fracturing even though the fluids used in this process are immediately sucked out of the well after pathways have been created in the rock to free the natural gas.

Not only have the states traditionally regulated hydraulic fracturing, an IOGCC survey concluded that not a single instance of harm to drinking water was found in over one million hydraulic fracturing operations. Thus, state regulation has proved effective in protecting drinking water from all drilling activities, including hydraulic fracturing. In these circumstances, another layer of regulations at the Federal level would not result in cleaner water but only in adding significant cost. Such unnecessary regulation and the concomitant cost can only serve to retard the development of much needed natural gas in this country.

The IOGCC has a resolution, No. 03.101, attached, addressing this issue. The IOGCC applauds the provisions of the Energy Policy Act of 2005 in this respect.

Stormwater Runoff. The Environmental Protection Agency has proposed a regulation extending the requirement for a pre-construction Federal permit under the Clean Water Act (CWA) to encompass building sites of one acre. In doing so, EPA has interpreted the oil and gas exemption in the CWA as not including the construction period for the well site and any needed road to the site. However, the EPA has opined that, as soon as drilling begins, the exemption does apply. Thus, EPA's proposed rule would only apply to the short construction period (days or a week) for most sites in the lower-48 states. It is estimated that this new permitting requirement could delay drilling operations by months.

The IOGCC supports the provisions of the Energy Policy Act of 2005 which address this critical problem.

I would like to also mention one other area of great concern to the states and the IOGCC. It is the critical need in this country for energy education.

Energy Education. Many of the problems we face would be greatly eased with a better public understanding of energy and its important role in our economy. The public's relative lack of understanding of the energy industry poses a real barrier to oil and natural gas production in this country. Too often, under the banner of environmentalism, natural gas development projects are held up and delayed based on misinformation and lack of understanding. The lack of energy education in this country can be viewed as an important barrier to natural gas development. IOGCC Resolution 03.105 "Urging the Need for a National Energy Education Program" is attached.

The IOGCC urges the federal government join the governors of the IOGCC in contributing to the development of a national educational program. The IOGCC has also proposed a publicly funded energy education program. Managed by the Energy Education Coordinating Council, this wide-ranging program would seek to reach all Americans with the facts, risks, benefits, and costs associated with our energy supplies and choices.

Thank you for the opportunity to appear here today. If we can provide any additional information, please do not hesitate to ask.

ABOUT CHAIRMAN CARRILLO:

A native of Abilene, Texas, Victor Carrillo joined the Texas Railroad Commission in February 2003 when Governor Rick Perry appointed him to fill the unexpired term of Tony Garza who became U.S. Ambassador to Mexico. The Texas Railroad Commission oversees the Texas oil and gas, pipeline and mining industry. Carrillo's colleagues unanimously elected him Chairman in September of 2003. In November, 2004, Chairman Carrillo won his first statewide election garnering almost four million votes and securing a six-year term of office.

Chairman Carrillo is Chairman of the Texas Energy Planning Council whose mission is to create a comprehensive energy plan for the State of Texas.

Victor was recently appointed by the U.S. Secretary of the Interior to serve as Texas' representative on the Outer Continental Shelf (OCS) Advisory Committee. This committee advises the Secretary of the Interior by reviewing and commenting on all aspects of leasing, exploration, development and protection of OCS lands.

Texas Governor Rick Perry recently appointed Victor to be Texas' representative to the Interstate Oil & Gas Compact Commission. Victor is also a member of an Interstate Oil & Gas Compact Commission/US EPA task force whose mission is to improve cooperation between state oil and gas regulatory officials and the federal EPA.

Much of Carrillo's education and professional experience relate to oil and gas exploration and production. He has a B.S. degree in geology from Hardin-Simmons University and a M.S. degree in geology from Baylor University. In 1988, he joined Amoco Production Company in Houston as a petroleum geophysicist where he gained experience in the full spectrum of oil and gas exploration and production activities.

From 1990-1994, while working professionally for Amoco by day, Victor attended the University of Houston Law Center at night, earning his law degree in 1994 with an emphasis in environmental and oil and gas law. From 1994-96, Victor worked as an energy attorney at the General Land Office where he advised the land commissioner on oil and gas, environmental, and general government issues.

In 1996, Victor and his family returned to Abilene, his hometown, where he served as assistant city attorney and later taught political science and legal studies at Hardin-Simmons University, his alma mater. He ran for and won election to the Abilene City Council, where he served until he was appointed as Taylor County Judge. In November of 2002, he was elected to a four-year term as Taylor County Judge, the position he held when the governor appointed him to the Texas Railroad Commission.

Victor and his wife, Joy, have been married 20 years and have three daughters whom they home educate.